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THE COMPETITIVE SCENARIO OF HOUSING FINANCE SECTOR IN INDIA

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ABSTRACT

Liberalization of the housing finance sector has paved the way for rapid growth of housing finance in India. Over the years, the mix of market orientation of the housing finance system and an enabling regulatory framework has lent the much desired vibrancy to the housing market. The vibrancy is manifested in the intense competition among lenders and the wide choices available to borrowers. Lower lending rates, stable property prices, rising personal incomes and tax incentives for owner occupied homes have contributed to the increase in the demand for housing finance. Policy makers and the housing industry alike are oriented towards affordable housing in order to develop an inclusive housing finance sector. The builder community and lending institutions have awakened to the huge market potential for affordable housing for lower income households. In the light of the vibrancy of the sector, the article attempts to capture the competitive scenario the Housing Finance Sector in India.

KEYWORDS: Housing Finance, housing finance companies, scheduled commercial banks.

INTRODUCTION:

The Indian housing finance sector has come a long way from its earlier phase of government domination to an increasingly market oriented system in the present times. The establishment of public sector institutions such as the Housing and Urban Development Corporation Limited (HUDCO) and the National Housing Bank (NHB), and the Housing Development Finance Corporation Limited (HDFC) in the private sector, in the 1970s and 1980s brought the much needed focus to the housing finance sector and propelled the system into a higher growth trajectory. In the 1990s, the process of liberalization of the financial sector provided further impetus to the sector with the entry of private financial institutions and banks. Public sector banks too turned to the housing finance sector in a major way and now claim a lion's share of nearly 70% of the total outstanding home loans. The outstanding home loans of the Scheduled Commercial Banks (SCBs) in the year 2003-04 stood at Rs.853.47 billion which amounted to a 73% rise over the home loan level in previous fiscal year. This is the sharpest rise recorded over a span of 27 years since 1990-91. In recent years though, the annual growth rates in outstanding housing loans of SCBs have slowed down and there has been a marginal decline in its market share vis-à-vis the housing finance companies.

Liberalization of the housing finance sector has paved the way for rapid growth of housing finance in India. Over the years, the mix of market orientation of the housing finance system and an enabling regulatory framework has lent the much desired vibrancy to the housing market. The vibrancy is manifested in the intense competition among lenders and the wide choices available to borrowers. Lower lending rates, stable property prices, rising personal incomes and tax incentives for owner occupied homes have contributed to the increase in the demand for housing finance.

The supply of housing finance has expanded under priority sector lending, refinance by the NHB, increased budgetary allocations to the housing sector and increased participation of private sector lending institutions. Securitization of housing loans, although at an initial stage, has provided an additional source of funds. At the same time, rising housing aspirations and rapid pace of urbanization are resulting into a widening gap between the demand and supply of housing. Since 96 percent of the urban housing shortage is in the categories of EWS and LIG, which adds up to 18 million as on 2012, there is an increased thrust on “Affordable Housing” in the present times. Policy makers and the housing industry alike are oriented towards affordable housing in order to develop an inclusive housing finance sector. The builder community and lending institutions have awakened to the huge market potential for affordable housing for lower income households.

The emphasis on institutional development has also fructified in terms of enhanced flow of funds to the housing sector. Regulatory changes permitted the commercial banks, with their vast network of branches to increase their retail lending activities, unleashing monetary resources for housing finance. Increase in the number of lending institutions, be it banks or housing finance companies instilled greater competition in the system with its characteristic benefits. Refinance facility extended by the NHB too has provided lending institutions with the necessary liquidity as well as the scope for profits. It would not be an overstatement to say that easy availability of housing finance at unprecedented low rates of interest has been the single most significant factor that has driven the growth of the housing sector.

In the context of low income housing, a NHB study (2010), 'Building Homes, Financing Homes', reports strong evidence that the low income housing market in India has grown rapidly in the past couple of years. The largely under-served low income, informal sector urban households offer huge potential for profitable supply of housing owing to its sheer size. There is a growing interest among the developers, including large, established and corporate developers, and new housing finance companies in this segment. Availability of housing finance for these households has shown improvement, lending support to the fact that they are a commercially viable segment, provided financial products and construction technologies are suitably structured and modified.

Housing Finance Companies (HFCs):

The non-banking finance companies (NBFC) entered into the housing finance sector by incorporating as Housing Finance Companies. A NBFC is classified as a HFC if its principal objective is to provide housing finance or in the case of competing objectives, where housing finance figures as the major component of the company's asset.

In the mid and late 1980s, HFCs were set up as private limited companies like the Dewan Housing Finance Limited or as joint ventures with state governments like the Gujarat Rural Housing Finance Corporation, or bank-sponsored HFCs like Can Fin Homes, SBI Home Finance, PNB Housing Finance, etc. State owned insurance companies like the LIC and the GIC also set up their own housing finance subsidiaries. Some other HFCs are Global Home Finance Ltd., Birla Home Finance Ltd., Tata Home Finance Ltd., Maharshi HFC Ltd., Parashwanath HFC, etc. Some of the above mentioned HFCs were later merged with their parent banks or have been acquired by some other financial institutions. Several new housing finance companies have entered into low income housing segment with a thrust on continuous innovations in the areas of risk assessment, recovery mechanisms, etc. These HFCs include Micro Housing Finance Corporation Limited (MHFCL), Dewan Housing Finance Limited (DHFL), Gujarat Rural Housing Finance Corporation (GRUH), Self-employed Women's Association Finance (SEWA), MAS Rural Housing and Mortgage Finance Limited, Mahindra Rural Housing Finance Limited (MRHFL), etc. The average loan sizes of these firms range from INR 0.2 million to INR 0.6 million, according to a study commissioned by NHB. (Source: Monitor Company Group, a study commissioned by NHB).

About 85 HFCs are registered with the NHB which is the regulatory bank for the HFCs. Total loan portfolio of HFCs in March 2017 was INR 7,700 Billion of which 67% comprises of home loans. According to ICRA 83% of home loans are lent by five dominant HFCs of which HDFC and LIC together hold a market share of 57% of home loans. This is followed by three other major HFCs, namely, DHFL, Indiabulls Housing Finance and PNB HFL with combined market share of 26%. With the focus on affordable housing and therefore affordable housing finance, it may be anticipated that the market structure of HFCs is likely to change with more and more players entering into this segment. A pointer to this is the entry of close to 25 new HFCs since the year 2015. Top HFCs operating in India, currently, are HDFC, LICHFL, DHFL, IBHFL and PNBHFL. Their shares in the housing finance sector are depicted in Fig. 1

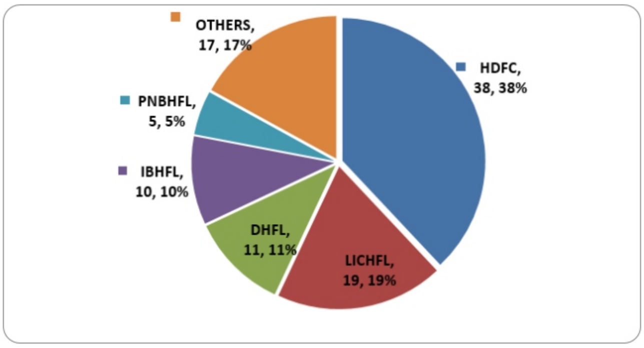

Fig. 1 Top Five Housing Finance Companies in India – 2017

Source: ICRA Industry Update for Mar- 2017

Housing Finance Scenario in India: An Overview of the Market:

The changing market structure of the housing finance system in India can be traced from the institutional changes that have taken place over the years. Incidentally, the term 'market structure' in the context of housing finance is used to refer to the 'proportion of outstanding mortgages held by each type of lender' (Gillies and Curtis, 1955). Mao (1958) defines market structure as the 'percentage distribution of home mortgages among various types of lenders.' In the present study we use the term in a broader sense to represent the market share of major institutions lending to the housing sector and outstanding home loans broad categories of 'lender-type.'

Up to the late 1990s, the sector was largely composed of specialized HFCs and those sponsored by banks and insurance companies. Besides these, there were HFCs promoted by builders and private companies. The second phase, between 1998 and 2003 saw an upsurge of commercial banks in the housing finance market leading to increased competition and rapid increase in disbursal of home loans. Irrational competition resulted into the sellers' market turning into a buyers' market with the customer being spoiled for choice. The bargaining power of buyers improved to a great extent even as they commanded quality services (UN-Habitat, 2008). It was a phase wherein HFCs lost a lot of market share. However, as issues of the quality of credit emerged, there was some rationalization in the operations of the players in the market.

HFCs, local and foreign commercial banks, and other non-bank finance companies are the major players in the industry. Presently, one can observe an oligopolistic structure in the housing finance market with four major players, namely, HDFC, which is the largest HFC; the ICICI Bank, which is the largest private sector bank; State Bank of India, the public sector bank and also the largest bank in India; and the LICHFL, promoted by the life insurance major, LIC. Being large mobilizer of savings and having a considerable spread across the country, each of these institutions has a strong presence in the housing finance market in India. The major institutional players of the housing finance market in India are depicted in Fig. 2.

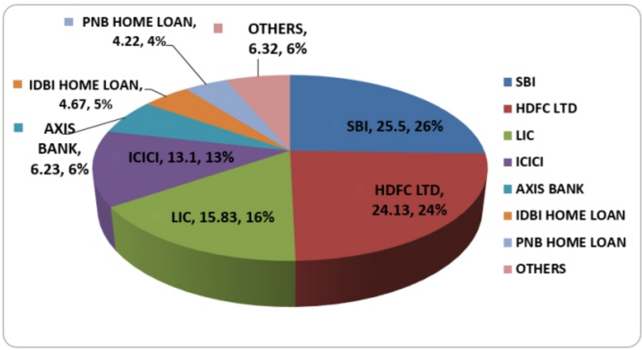

Fig. 2. Shares of Major Institutions in the Housing Finance Sector (2017)

Source: ICRA Industry Update for Mar- 2017

Housing Finance Companies vis-à-vis Scheduled Commercial Banks:

Housing finance companies face stiff competition from the banking sector which has the advantage of a well spread network of branches. One of the most elementary differences between HFCs and SCBs is with respect to their sources of funds. Commercial banks have access to cheaper floating-rate deposits through wide network of branches. This allows them to undercut HFC pricing, particularly in urban areas. Given that deposits are their major sources of funds, banks are more likely to offer floating-rate loans which reduce their interest rate risks and which are also the preferred home loan product of Indian borrowers. It also enables banks to reduce mismatches in the tenure of their assets and liabilities.

The sources of funds for HFCs are public deposits, subject to NHB regulations; refinance from NHB; and institutional borrowings apart from equity. Only those HFCs who meet the NHB criteria of minimum net owned funds are permitted to raise public deposits. HFCs can provide long-term fixed rate housing loans because their funding primarily consists of refinance from the NHB and foreign commercial borrowings. To some extent, they also source their funds at floating rate credit from banks and fixed deposits from the public. Some highly rated large HFCs could access funds through securitization. In general it may be stated that HFCs have a higher cost of funding compared to commercial banks. Government restrictions on external commercial borrowings have also reduced the availability of funds for HFCs.

Overshadowed by the banks, HFCs have yet to realize their full potential given the lower degree of their geographical penetration. Higher cost of their funds and stricter capital provisioning norms put them at a disadvantage. In the case of some HFCs consolidation has been observed as some of the smaller HFCs have been acquired by the larger ones and some others have closed down business. HFCs and banks also differ with respect to their target markets, business models and products. Commercial banks focus predominantly on large urban areas and higher income borrowers. Since they have many branches, they normally go for cross-selling of their products. Consequently, while their specialized mortgage lending skills are not widely developed, they get the advantage of lower administration costs. While some HFCs focus on urban areas, their target borrowers have been more diverse. Typically HFCs have served lower and middle income borrowers. It may be stated that HFCs are perceived to have a higher developmental impact due to their thrust on catering to underserved customers in semi urban and rural areas. As regards mortgage products, the HFCs tend to offer more flexible and creative products to attract customers. They traditionally offer fixed rate products, while commercial banks focus on floating-rate products.

The clientele of banks and HFCs include individual home buyers, professionals for non-residential premises, non-resident Indians and individuals of Indian origin for purchasing or constructing housing units in India. They also cater to corporate clients who provide housing facility to their employees anywhere in India. Some financial institutions also provide loans against rent receivables. This practice is a response to the emergence of information technology and business process out-sourcing sectors, which normally prefer to take business premises on lease. The financial institutions grant loans to the owners of these commercial complexes based on the lease rental discounting. Likewise, loans are also made available to approved developers for their housing projects on rent receivables from their tenants.

The relative advantage of HFCs in comparison to commercial banks lies in their specialized skills as housing finance is their core activity. For the banks, as mentioned earlier, housing finance is only one of the many banking services they provide. However, typical problem faced by HFCs are the higher cost of funds, declining profit margins as a result of increased competition from banks, and lack of parity with banks as far as capital adequacy norms are concerned. HFCs for instance are required to maintain a minimum capital adequacy ratio of 12% compared to 9% for commercial banks, as of 2009. The peak period of housing loan sector in India, around 2003-04, also witnessed the majority of consolidation activity among HFCs, with the smaller HFCs, in particularly, getting merged with their own parent organizations. This was especially the case with bank-sponsored HFCs. Some of the instances of the mergers are the SBI HFL, BOB HFL, Andhra Bank HFL, ViBank HFL, Ind Bank HFL, etc., with their respective parent banks. Some of the other major consolidations were the acquisition of Vyasya Bank HFL by a larger HFC, namely, Dewan Housing Finance Corporation; acquisition of the housing loans segment of Citibank by LICHFL; takeover of Tata Home Finance Ltd. by the IDBI Bank, and so on.

Despite the intense pace of growth in housing finance in India over the past years, there remains a vast open field to be covered. This is evident from the low mortgage penetration in India which is just nine percent measured as the ratio of dissemination of housing finance to Gross Domestic Product. This ratio is comparatively very low with respect to advanced countries such as US, UK and Denmark. India compares poorly with other Asian countries as well. For example, Malaysia has a mortgage debt to GDP ratio of 34%, Thailand with 20% followed by China 17%. Commercial banks are expected to continue to command larger market share owing to their advantageous position in terms of extensive network of branches and access to a steady flow of low cost funds in the form of deposits. Moreover, banks are mandated to meet housing finance targets under the priority sector lending. There is an increased competition among commercial banks to improve their portfolio of home loans by offering competitive terms of loan.

Further momentum to the housing finance expansion is anticipated by the fact that while the housing finance market of India is dynamic, organized or formal housing finance accounts for approximately only one-fourth of the total capital expended in housing in India, and caters largely to the upper income groups. The huge scope in housing for low and moderate income (LMI) households offers much to be deliberated upon for creating an inclusive housing finance sector. It is

for these reasons that mortgage lending is a growing business in India with enormous opportunities.

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